Forbearance Cannot Be Granted as a Matter of Law OR as a Matter of Policy

I. Section 10(d)'s Limitations on Forbearance Apply to the OI&M Safeguard.

1. The Commission has already held that the OI&M restriction is "required" by the "operate independently" requirement of Section 272:

a. *Non-Accounting Safeguards Order* ¶ 163: "[a]llowing a BOC to contract with the section 272 affiliate for operating, installation and maintenance services would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors." (emphasis added).

b. Verizon's assertion that the OI&M safeguard was not "required" because the Commission, in exercising its authority to interpret the scope of "operate independently" determined that it did not prohibit a BOC and its section 272 affiliate from integrating functions such as marketing, sales, advertising, service design and development, product management, facilities planning, and other activities, *Non-Accounting Safeguards Third Order On Reconsideration* ¶¶ 14-18 (dealing with the requested but not adopted non-OI&M structural separation requirements imposed in other rulemaking proceedings) is misplaced, because the Commission held that "operate independently"' was not ambiguous with respect to OI&M services. The Commission held in that same decision when discussing OI&M rather than administrative services that "*independent operation would be precluded*" absent the OI&M safeguard, *id* ¶ 20. It similarly held that "joint provision of OI&M services "*is the antithesis of genuine independent operation*" *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 12. Clearly, the OI&M safeguard was "required" by the statutory "operate independently" mandate.

c. As demonstrated in AT&T's filings in this proceeding, the OI&M safeguard is even more necessary today than when first adopted. Thus, Verizon has represented that its Section 272 affiliate would no longer upgrade its OSS for purposes of providing OI&M services, relying on the BOC to do so. AT&T, through its expert Dr. Selwyn, has demonstrated how: (a) there could be discriminatory access and a misallocation of costs to the monopoly ILEC ratepayers if the BOC were to undertake the OSS upgrades; (b) how Verizon, by exploiting a "prevailing company price" loophole for affiliate transactions, could charge GNI an artificially low price for OI&M services facilitating potential anticompetitive price squeezes by GNI; (c) how even if *CALLS* were "pure price caps," Verizon would still have a powerful incentive to shift costs *out* of its long distance affiliates so as to enhance their ability to compete with nonintegrated rivals; and

(d) that *CALLS* is not "pure price caps" because it is scheduled to expire in July 2005 and likely to be reexamined because of inadequate competition to constrain rates effectively, thus affecting BOC's current cost allocation incentives and behavior.

d. As shown in AT&T's July 9, 2003 *ex parte* submission, the term "requirement" includes both the "provisions" of the Act *and* the FCC's implementing "regulations." Thus, section 252(e)(2)(B) forbids a state commission from approving an interconnection agreement "if it finds that the agreement does not meet the requirements of section 251, *including the regulations prescribed by the Commission pursuant to section 251*, or the standards set forth in subsection (d) of this section." Likewise in section 251(b)(2), LECs are obligated to provide "number portability in accordance with the requirements prescribed by the Commission" which include Commission regulations. The FCC in its 1998 *NOI*, treated the term "requirement" in section 10(d) as applying to "statutory provisions" and to "implementing regulations." 13 FCC Rcd. 21879 ¶ 31 (1998).

2. Section 10(d)'s limitation on the forbearance authority of the Commission *expressly* applies to Section 271(d)(3)(B), which in turn *expressly* incorporates the requirements of Section 272.

a. Section 10(d) provides that "*the Commission may not forbear from applying the requirements of section 251(c) or 271 of this title* ..." Verizon does not dispute that under this Section the Commission may not forbear from applying Section 271(d)(3). That section provides that the Commission "*shall not approve* the [long distance] authorization requested . . . unless it finds that . . . (B) the requested authorization will be carried out *in accordance with the requirements of section 272* of this section." (emphasis added). The reference to Section 271 necessarily includes Section 271(d)(3) which necessarily includes Section 272. In *none* of the cases cited by Verizon in its October 1, 2003 *ex parte* at 8-9 was there even a claim of a comparable inclusion by reference. *Compare, Estate of Leder v. Commissioner of Internal Revenue*, 893 F.2d 237, 241 (10th Cir. 1989)("The *only* inference we can draw from this express cross reference [in Section 2035(d)(2) of the Internal Revenue Code to Section 2042 of the same Code] is that Congress, in enacting subsection (d) meant to construe Sections 2035(d)(2) and 2042 in *pari materia*" emphasis added).

b. Section 271(d)(3) shields from forbearance only those section 272 requirements that relate to the BOCs' provision of interLATA services that require Commission "authorization;" that is, only the section 272 requirements that must be satisfied as a prerequisite to long distance authorization under section 271(d). The Common Carrier Bureau in the *Section 272 Forbearance Order*, 13 FCC Rcd. 2627 which was never appealed, and which clearly was within its delegated authority to apply the literal language of Section 10(d), held:

- "Based on our interpretation of the Communications Act provisions, we conclude, . . .that prior to their full implementation we lack authority to forbear from application of the requirements of section 272 to any service for which the BOC must obtain prior authorization under section 271(d)(3)." ¶ 22.
- "We believe that section 10(d), read in conjunction with section 271(d)(3)(B), precludes our forbearance for a designated period from section 272 requirements with regard to any service for which a BOC must obtain prior authorization pursuant to section 271(d)(3)." ¶ 23.

c. As explained in AT&T's July 9, 2003 *ex parte*, Verizon's attempt to draw a distinction between market-opening provisions (sections 251 and 271) and competition-safeguarding provisions (section 272), is irrational. Verizon nowhere explains why Congress would have thought it vital to open markets to competition, but of less urgency to safeguard the competition so difficult to create. In fact, Congress made no such distinction.

3. Verizon, in the Section 271 proceedings has agreed that the requirements of Section 271(d)(3)(B) are prospective in nature incorporating the Section 272 requirements as of the day the BOC received Section 271 approval.

a. Verizon has, in each of the Section 271 proceedings agreed that under Section 271(d)(3)(B) it was prospectively bound to comply with Section 272 as it was construed on the day Verizon received Section 272 approval, *which includes the OI&M safeguard.* Thus, in the New York 271 proceeding, the Commission: (i) noted that "Section 271(d)(3)(B) requires that the Commission shall not approve a BOC's application to provide interLATA services unless the BOC demonstrates that the 'requested authorization will be carried out in accordance with the requirements of section 272'," (ii) referred to the "standards for compliance with section 272 in the ... Non-Accounting Safeguards Order," and (iii) then cited to Bell Atlantic's commitment "that it *will comply* with section 272(b)(1), which requires ... (3) no provision by the BOC (or other non- section 272 affiliate) of operation, installation, and maintenance services (OI&M) with respect to the section 272 affiliate's facilities; and (4) no provision of OI&M by the section 272 affiliate with respect to the BOC's facilities." *Verizon New York 271 Order*, 15 FCC Rcd 3953, ¶¶ 401, 406 (1999) (emphasis added). This New York commitment was explicitly referenced in each subsequent 271 proceeding. *See, e.g. Verizon Pennsylvania 271 Order*, 16 FCC Rcd. 17419, ¶ 124 (2001) ("we conclude that Verizon has demonstrated that it *will comply* with the requirements of section 272. Significantly, Verizon provides evidence that it maintains the *same* structural separation and nondiscrimination safeguards in Pennsylvania, as it does in Connecticut, *New York* and Massachusetts"); *Verizon New Jersey 271 Order*, 17 FCC Rcd 12275, ¶ 165 (2002) (same, citing also to the Pennsylvania Order).

c. The Commission has made clear that the Section 271(d)(3)(B) separate affiliate and related safeguards commitments made by the BOCs extended through Section 272 sunset. Memorandum Opinion and Order, *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, 17 FCC Rcd. 26869 (2002) at ¶14 ("Under a state-by-state sunset, the separate affiliate and related safeguards of section 272 *will apply* in each state for three years after grant of a section 271 application. A requirement that each section 271 application show that in-region, interLATA entry *will comply* with the separate affiliate and related requirements of section 272 is entirely consistent with this." (emphasis added).

II. In Any Event the Unrebutted Record Shows that the OI&M Safeguard is Necessary to Prevent Cost Misallocation and Discrimination

1. AT&T Has demonstrated that the OI&M safeguard is *necessary* to prevent *cost misallocation* and that price cap regulation does not disincent such misconduct

a. Dr. Selwyn demonstrated how there could be a misallocation of costs to the monopoly ILEC ratepayers if the BOC were to undertake any upgrades *e.g.*, to its existing operations support system ("OSS"). *Ex Parte* Declaration of Lee L. Selwyn, July 9, 2003 ¶¶ 17-18. Verizon has stated that if it receives OI&M forbearance, its Section 272 affiliate will no longer upgrade its OSS for purposes of providing OI&M services, relying on the BOC to do so. June 4 *ex parte*, Attachment 3 at 5, note 4.

b. Dr. Selwyn demonstrated how there could be a misallocation of costs if, as Verizon claims (Howard Supplemental Declaration ¶ 5; *see also*, Verizon August 11, 2003 *ex parte* at 2) it has no excess capacity to provide OI&M services. *Ex Parte* Declaration of Lee L. Selwyn, July 9, 2003 ¶ 19. Cost misallocation can arise to the extent that additional employees or other assets had to be added.

c. Verizon's assurance that it "would file Cost Allocation Manual ('CAM') changes to capture these costs," using time reporting codes "*to be* created and *defined*" (Verizon June 24, 2003 *ex parte* at 4) and "new non-regulated cost pools as *necessary*" (Verizon August 11, 2003 *ex parte* at 3) is meaningless in light of the italicized qualifications, not credible since their Petition suggests that neither is necessary, (Verizon's *Petition for Forbearance* at 4) nor helpful. Nor would meaningful definitions and the inclusion of necessary cost pools cure the problem. For example, the CAM data, even with the changes proposed by Verizon would not, allow regulators to determine whether or how the BOC allocated joint OI&M costs.

d. Dr. Selwyn demonstrated that even if *CALLS* were "pure price caps," BOCs would still have a powerful incentive to shift costs *out* of its long distance affiliates so as to

enhance their ability to compete with nonintegrated rivals. Ex Parte Declarations of Lee L. Selwyn, in CC Docket No. 96-149, November 15, 2002 ¶¶ 44-45; Declaration of Lee L. Selwyn appended to AT&T's Comments in the *Non-Dominance FNPRM* (June 30, 2003) ¶¶ 97-103; Reply Declaration of Lee L. Selwyn appended to AT&T's Comments in the *Non-Dominance FNPRM* (July 28, 2003) ¶¶ 57-58.

e. In any event Dr. Selwyn demonstrated that *CALLS* is not "pure price caps" as SBC claims, because it is scheduled to expire in July 2005, and the Commission has expressly committed to reexamine ILEC price caps if, at the time that *CALLS* expires, the level of competition is still not sufficient to constrain rates effectively. This affects Verizon's current incentives and conduct. If Verizon is able to load costs onto its ILECs, those costs (if not detected and eliminated) could then be used to support a higher overall ILEC access charge rate level and a less onerous (from Verizon's perspective) price adjustment mechanism under a reexamination of CALLS and possible reinitialization of access charges at the 11.25% ILEC authorized rate of return.

f. Verizon's claims that it will provide OI&M services to unaffiliated entities on a nondiscriminatory basis are disingenuous, considering that Verizon regularly structures its affiliate transactions such that, as a practical matter, only the Verizon affiliate is capable of using the service or qualifying for the lowest price. For example, its Section 272(b) posting regarding billing and collection offers large discounts to "any" purchaser of these services that provides 85% of its *total* Verizon end user billing to Verizon for processing. The only entity that would typically qualify for this discount is, of course, Verizon Long Distance.

2. AT&T has demonstrated that the OI&M safeguard is *necessary* to prevent discrimination

AT&T has also developed a full record through Dr. Selwyn's declarations substantiating the likelihood of discrimination if the OI&M safeguard is removed, particularly with respect to superior access to the BOC's OSS. *See*, Ex Parte Declaration of Lee L. Selwyn, , July 9, 2003 ¶¶ 20-21.

Verizon has not submitted any declarations in response to Dr. Selwyn's expert testimony regarding either cost misallocation or discrimination.

3. Verizon's cost data, even if relevant, remains unsubstantiated.

a. Verizon's cost evidence is legally irrelevant. No matter how costly compliance with the OI&M safeguards is claimed to be, so long as there is a "strong connection" between those

safeguards and the protection of long distance competition, they are "necessary" within the meaning of Section 10 and forbearance may not be granted.

b. The *ipse dixit* cost savings numbers remain unverified and unverifiable. Moreover, the claimed OI&M savings could be achieved without eliminating the OI&M safeguards.

c. Verizon's cost analysis goes through 2006, even though the bulk of Verizon territory will be free of the OI&M safeguard in 2004 and 2005, materially and artificially inflates Verizon's costs by not taking into account the impact of these Section 272 sunsets. Assuming that the Commission will, as occurred in New York, allow section 272 to sunset without extension in the remaining Verizon states, section 272 will sunset in Massachusetts in April, 2004; in Pennsylvania in September, 2004; in New Jersey in March 2005; and in Virginia in October 2005.

III. Should the Commission now forbear the OI&M requirement, the non-dominance determination in the *LEC Classification Order* would no longer be valid

The Commission, in finding the BOCs non-dominant in the *LEC Classification Order*, did so because the BOCs' affiliates were required by section 272 to be "structurally separate" from the BOCs and to "operate independently" from the BOCs. At the time the *LEC Classification Order* was issued, the "operate independently" requirement had been construed by the Commission to include the OI&M restriction.